Supreme Court, U.S.
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# Supreme Court of the United States

October Term, 1993

BALTIMORE CITY LODGE NUMBER 3,
FRATERNAL ORDER OF POLICE

*Petitioners,*

v.

MAYOR AND CITY COUNCIL OF BALTIMORE,
*Respondents.*

## PETITION OF THE FRATERNAL ORDER OF POLICE FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPPEALS FOR THE FOURTH CIRCUIT

## PETITION FOR WRIT OF CERTIORARI

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## QUESTION PRESENTED

What standard of deference should the courts accord to a governmental entity's determination that an impairment of its own contractual obligation to pay funded salaries is necessary and reasonable?

## PARTIES IN THE PROCEEDINGS BELOW

The cases were consolidated by the court of appeals. Although the parties' respective cases were not consolidated by the district court, their claims were addressed in a single memorandum opinion. The parties were as follows:

U.S.C.A. No. 92-2234

BALTIMORE TEACHERS UNION, AMERICAN FEDERATION OF TEACHERS LOCAL 340, AFL-CIO; THE CITY UNION OF BALTIMORE, AMERICAN FEDERATION OF TEACHERS, LOCAL 800, AFL-CIO,

Plaintiffs-Appellees,

v.

MAYOR AND CITY COUNCIL OF BALTIMORE; KURT L. SCHMOKE, Individually and in his capacity as Mayor and Member of the Board of Estimates of Baltimore City; MARY PAT CLARKE, Individually and in her capacity as President of the Baltimore City Council and Member of the Board of Estimates of Baltimore City; JACQUELINE F. MCLEAN, Individually and in her capacity as Comptroller and Member of the Board of Estimates of Baltimore City; NEAL JANEY, In his capacity as Member of the Board of

Estimates of Baltimore City; GEORGE F. BALOG, Individually and in his capacity as Member of the Board of Estimates of Baltimore City; BOARD OF ESTIMATES OF BALTIMORE CITY

Defendants-Appellants.

U.S.C.A. No. 92-2237

In Re: STATE OF MARYLAND,

Appellant,

v.

Same parties as in U.S.C.A. No. 92-2234(L)

U.S.C.A. No. 92-2238

BALTIMORE CITY LODGE NUMBER 3 FRATERNAL ORDER OF POLICE,

Plaintiff-Appellee,

v.

MAYOR AND CITY COUNCIL OF BALTIMORE,

Defendant

None of the parties is a private business entity either publicly traded or privately held.

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WHEN A GOVERNMENTAL ENTITY SUBSTANTIALLY IMPAIRS ITS OWN CONTRACTUAL OBLIGATIONS TO PAY FUNDED SALARIES, IT IS INAPPROPRIATE FOR A COURT TO DEFER TO THE GOVERNMENTAL ENTITY'S DECISION TO IMPAIR ITS OWN CONTRACTS, PARTICULARLY WHEN BUDGETARY SHORTFALLS MAY BE COVERED FROM OTHER SOURCES.


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No.

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OCTOBER TERM, 1993

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BALTIMORE TEACHERS UNION,
AMERICAN FEDERATION OF TEACHERS,
LOCAL 340, AFL-CIO, ET AL.,

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PETITION OF THE
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TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

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## OPINIONS BELOW

The district court's opinion of September 18, 1992, captioned as Baltimore City Lodge No. 3, Fraternal Order of Police v. Mayor and City Council

of Baltimore appears at 801 F.Supp. 1506 (D. Md. 1992).

The Fourth Circuit's opinion of September 2, 1993, captioned as Baltimore Teachers Union, American Federation of Teachers Local340, AFL-CIO v. Mayor and City Council of Baltimore appears at 6 F.3d 1012 (1993).

The Fourth Circuit denied the Baltimore Teachers Union's petition for rehearing with suggestion for hearing en bank on October 8, 1993, without opinion. An amended order and dissenting opinion were issued on October 12, 1993, and were reported at 6 F.3d 1012 (1993).

## JURISDICTIONAL STATEMENT

The final judgment of the Fourth Circuit of which review is sought was entered on September 2, 1993. A petition for rehearing and suggestion for

rehearing en banc, timely filed by the Baltimore Teachers Union and City Union of Baltimore, were denied on October 8, 1993, then by an amended order issued October 12, 1993. Review is sought by way of a writ of certiorari pursuant to Supreme Court Rule 13 and 28 U.S.C. Sec. 1254 (1).

## CONSTITUTIONAL PROVISIONS

U.S. Const. art. I, Sec. 10, cl. 1

"No state shall...pass any...Law impairing the Obligation of Contracts."

## STATEMENT OF THE CASE

On November 19, 1991, the Fraternal Order of Police and the Department entered into a Memorandum of Understanding For Police Officers, Police Agents and Flying Officers to be in effect from July 1, 1991 until June 30,

1993, and a Memorandum of Understanding for Police Sergeants and Police Lieutenants to be in effect from July 1, 1991 until June 30, 1993. Listed among the purposes of each Memorandum was to provide a clear statement of wages, hours and working conditions and of the respective rights and obligations of labor and management. Both Memoranda established that employees would be compensated according to a fixed schedule included in each Memorandum and that the employees were entitled to observe and be paid for certain legal holidays indicated therein. The provisions of the Memoranda requiring budgetary approval were submitted and approved by the Baltimore City Council.

On January 13, 1992, Baltimore City Mayor Kurt L. Schmoke announced a "furlough plan" which would be instituted

for the City Employees, including police officers. Pursuant to the Mayor's furlough plan, each member of the Department, including police officer, police agent, flying officer, police sergeant and police lieutenant would lose the equivalent of one-half of one day's pay in the following ten pay periods. The plan was terminated after five pay periods, at which time the fiscal "crisis" was determined to be less urgent than expected. The result was the loss of two and one-half days of pay. No provisions for subsequent repayment have since been made. The Mayor classified the decrease as the State's opting to not pay officers for five holidays even though the decreased payments were not to be made within the respective periods.

On September 18, 1992, the United States District Court for the District of

Maryland granted the Fraternal Order of Police's Motion for Summary Judgment and thus directed that all money which had been deducted from the officers' salaries pursuant to the Board of Estimates' January 16, 1992 resolution be returned to the police officers within thirty days.

The Mayor and City Council of Baltimore filed a notice of appeal to the United States Court of Appeals for the Fourth Circuit on September 29, 1992. In a published opinion, the United States Court of Appeals for the Fourth Circuit reversed and remanded the district court's decision, finding that the City's furlough plan did not violate the Contracts Clause of the United States Constitution.

The Fraternal Order of Police, Lodge 3, raised its federal constitutional

claims under the Contracts Clause, art. 1, §10, cl. 1 in its motion for summary judgment, its appellate court brief and at oral argument. In its district court memorandum in support of Motion for Summary Judgment the Fraternal Order of Police alleged that the City's "...action is subject to and invalid under the Contracts Clause of the United States Constitution, U.S. CONST. art. 1, § 10, cl. 1." The Fraternal Order of Police also asserted that "[t]he contract clause prohibits states from enacting laws that substantially impair contractual obligations unless such an impairment is reasonable and necessary to serve an important public purpose" and that "the reasonableness of impairment is to be judged in light of whether the state contractual obligations 'had effects that were unforseen and unintended by the

legislature'" when the contract creating those obligations and rights was created. These same concerns were reiterated before the court of appeals in the Petitioner's brief and oral argument.

The United States Court of Appeals for the Fourth Circuit, after acknowledging that the Fraternal Order of Police had raised a claim under the contracts clause, reversed the district court's decision and held that no federal Constitutional violation occurred. The court found that a contract existed between the City and its police, that this contract was impaired and that this impairment was substantial. However, the court held that the impairment was not violative of the contracts clause because it was reasonable and necessary.

## REASONS FOR GRANTING THE WRIT

**WHEN A GOVERNMENTAL ENTITY SUBSTANTIALLY IMPAIRS ITS OWN CONTRACTUAL OBLIGATIONS TO PAY FUNDED SALARIES, IT IS INAPPROPRIATE FOR A COURT TO DEFER TO THE GOVERNMENTAL ENTITY'S DECISION TO IMPAIR ITS OWN CONTRACTS, PARTICULARLY WHEN BUDGETARY SHORTFALLS MAY BE COVERED FROM OTHER SOURCES.**

### A. The Fourth Circuit's Decision Creates A Conflict with Decisions Of This Court As Well As With Other Circuits.

In holding that the City's furlough plan was reasonable and necessary, although the Fourth Circuit putatively acknowledged the lessened deference given to a state's impairment of its own contracts, (see App. 27), the Fourth Circuit made it clear that it was deferring to the City:

> [t]he authority of the states to impair contracts, to be sure, must be constrained in some meaningful way. The Contract Clause, however, does not require the courts--even where public contracts have been impaired--to sit as

> superlegislatures, determining, for example, whether it would have been more appropriate instead for Baltimore to close its schools for a week, an option actually considered but rejected, or reduce funding to the arts, as appellees argue should have been done. Not only are we ill-equipped even to consider the evidence that would be relevant to such conflicting policy alternatives; we have no objective standards against which to assess the merit of the multitude of alternatives. While the Court today presumably would not accept in the public contract context the absoluteness of Justice Frankfurter's response to a similar request in a private contract context that the Court reject a governor's and legislature's determination that the state's public welfare required further suspension of mortgage foreclosures (or at least not the implication of his response), his essential point is relevant in both contexts: "Merely to enumerate the elements that have to be considered [in determining whether the public welfare decision was reasonable] shows that the place for determining their weight and their significance is the legislature not the judiciary." East New York Sav. Bank v. Hahn, 326 U.S. 230, 234 (1945).

App. 31-33 (emphasis added).

A recent Memorandum Opinion from the District of Maryland noted the shift in judicial deference effected by the Fourth Circuit's decision. "Baltimore Teachers, however, would see seem to make... discovery an exercise in futility, in the absence of an unlikely finding that the County or Board 'had it in for' the teachers regardless of budgetary concerns." Maryland State Teachers Ass'n v. Worcester County, Md, No. MJG 93-311, slip op. at 16 (D. Md. Nov 17, 1993).

> It is quite possible to read the decision in Baltimore Teachers to, as a practical matter, immunize the Board's actions here from effective judicial review. After all, it is a virtual certainty that the County will be able to show that it considered alternatives and made a reasonable (albeit unpleasant) choice to reduce the Board's budget and/or the teacher's salaries paid by the Board. Similarly, the Board will be able to show that a reasonable choice among alternatives was made in applying the reduction of its budget to teachers' salaries rather than other items.

Id. at 17. And see id. at 17-18, characterizing further discovery as efforts "likely to be fruitless," in light of the Fourth Circuit's ruling.

This standard is in direct conflict with that employed in decisions by this Court as well as other circuits. Indeed, because of a government's own temptation to abrogate its own contracts, its obligations assume a "special status," subject to heightened scrutiny. See Allied Structural Steel Co. v. Spannaus, 483 U.S. 234, 244, n.5 (1978). See also United States Trust v. New Jersey, 431 U.S. 1, 25-26 (1977), indicating that "complete deference to a legislative[1]

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[1] There is doubt that the "furlough" plan in this case even constitutes a "legislative" enactment. There was no change in the City Board of Estimates ordinance; there was no legislative action at all. Rather, the "furlough" plan was merely announced by

assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." See also Kestler v. North Carolina Local Government Employees' Retirement System, et al., 808 F. Supp 1220, 1226-27 (W.D.N.C. 1992) (court assumed no deference was due to legislative determination). Thus, as stated by this Court, "a State is not completely free to consider impairing the obligation of its own contracts on par with the policy alternatives." United States Trust Co. v. New Jersey, 431 U.S. 1, 30-31 (1977).

Although the Fourth Circuit deferred to the City's legislative judgment, other courts are not in accord. In Association of Surrogates and Supreme Court Reporters v. State of New York, 940 F.2d 766 (2nd.

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the Mayor as a fait accompli. See app. 37-38.

Cir. 1992), cert. denied 112 S. Ct. 936, 60 U.S.L.W. 3420 (1992) (Surrogates I), the Second Circuit rejected a claim that postponing New York employees' wage payments (as opposed to denying them outright) had only a minimal impact. The Second Circuit opined that the "lag-payroll scheme smack[ed] of political expediency that United States Trust warned of." Surrogates I, 940 F.2d at 773. The court further indicated: "[t]he contract clause, if it is to mean anything, must prohibit New York from dishonoring its existing contractual obligations when other policy alternatives are available." Id. at 774. The language employed is particularly noteworthy:"...[i]f a State government could so cavalierly disregard the obligations of its own contracts, of what value would its promises ever be?" Id.

The Surrogates I court applied the opposite presumption concerning the validity of the State's action than did the panel majority in this case.[2] Rather than acknowledging that State employees relied on the City's honoring their employment contracts, the majority imposed a limit on city employees' rights under the Federal Constitution: "[i]t should not be wholly unexpected, therefore, that these public servants might well be called upon to sacrifice

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[2] Three reported decisions followed Surrogates I. All three were in accord with Surrogates I. See Association of Surrogates and Supreme Court Reporters v. State of New York, 78 N.Y.2d 933, 573 N.Y.S.2d 19, 577 N.E.2d 10 (1991), cert. denied, 60 U.S.L.W. 2489 (1992) (Surrogates II); Association of Surrogates and Supreme Court Reporters v. State of New York, 577 N.Y.S.2d 386 (N.Y. App. Div. 1991); and Association of Surrogates and Supreme Court Reporters v. State of New York, 79 N.Y.2d 39, 580 N.Y.S.2d 153 588 N.E.2d 51 (N.Y. Ct. App. 1992).

first when the public interest demands sacrifice." App. 30.

Within the past year alone, the conflict has arisen in the District of Columbia, District of Columbia v. American Federation of Government, 619 A.2D 77 (D.C. APP. 1993). This issue also has been dealt with in Florida Chiles v. United Faculty of Florida, 615 So.2d 671 (Fla. 1993), New Hampshire Opinion of the Justices, 135 N.H. 625, 636, 609 A.2d 1204, 1211 (1992), Iowa AFSCME/Iowa Council 61 v. Iowa, 484 N.W.2d 390 (1992).

In a dissenting opinion filed with the Fourth Circuit's denial for rehearing en banc, Judge Francis Murnaghan asserted that the opinion filed by the panel was contrary to "...substantial authority, Federal and state, appearing to contradict the opinion of the two-judge

panel majority. A conflict of circuits emerges on an item of potentially immense importance." App. 43. Indeed, in the Worcester County case, Judge Garbis stated "...this Court--giving all due respect to the United States Court of Appeals for the Fourth Circuit--believes that the Supreme Court should grant a writ of certiorari in [Balimore Teachers] and issue a definitive decision different from that reached by the Fourth Circuit." Worcester County, No. MJG 93-311 at 22-23.

B. The Fourth Circuit's Decision Improperly Undermines the Protection of the Contracts Clause.

The circuit court's decision failed to analyze or discuss the language of the Supreme Court in United States Trust Company of New York v. New Jersey, 431

U.S. 1, 31-32 (1977), which indicated that the reasonableness of an impairment should be judged in light of whether the State contractual obligations had effects that were unforseen and unintended by the legislature when the contract creating those obligations and rights was created. This Court was clear that if the state was aware of the problems when it entered into a contract, the state could not subsequently impair the contract on the basis of problems that have not changed, or that have changed only in degree rather than in kind.

In reference to the police, the City knew as early as the Spring of 1991 that there would be decreases in funds available for the 1992 fiscal year. In fact, those decreases were the basis for holding salaries constant when negotiating the contract in question.

The City admitted that it was aware of further cuts in state aid made in October of 1991. There was no indication that the problems changed in degree, and they certainly did not change in kind. Further, an article in the November 9, 1991 edition of the Baltimore Sun attributes a quote to Baltimore City Mayor Kurt Schmoke that further cuts in the state were anticipated and would be necessary. This situation predated the November 19, 1991 agreement and subsequent ratification. Therefore, the City knew of the financial situation at the time the contracts were entered into, and the Supreme Court's statements in United States Trust indicate that the situation should not be a basis for abrogating the contracts.

Furthermore, the furlough program was not necessary. "Necessity is to be

judged on two levels: (1) whether a less drastic modification could have been implemented; and (2) whether, even without modification, the State could have achieved its goals." Maryland State Teachers Ass'n v. Hughes, 594 F. Supp. 1353, 1362 (1984), aff'd No. 84-2213 (4th Cir. 1985), cert. denied 475 U.S. 1140 (1986), citing United States Trust, 431 U.S. at 29-30.

In Association of Surrogates and Supreme Court Reporters v. State of New York, 940 F.2d 766 (2nd Cir. 1992), cert. denied 112 S. Ct. 936 (1992) (Surrogates I), the Second Circuit reviewed the propriety of a program similar to the one presented here. In striking the legislation down, the court opined that "[t]he contract clause, if it is to mean anything, must prohibit New York from dishonoring its existing contractual

obligations when other policy alternatives are available." Id. 940 F.2d at 774. Here, other alternatives were available. For example, Baltimore City originally intended to cut 10 million dollars in funding for the arts. However, in response to a strong letter writing campaign, this option was forgone. Other courts have followed the same rationale offered in Surrogates I. See also Association of Surrogates and Supreme Court Reporters v. State of New York, 78 N.Y.2nd 933, 573 N.Y.2nd 19, 577 N.E.2d 10 (1991), cert. denied, 60 U.S.L.W. 2489 (1992) (Surrogates II); Association of Surrogates and Supreme Court Reportersv. State of New York, 577 N.Y.S.2d 386 (N.Y. App. Div. 1991); and Association of Surrogates and Supreme Court Reporters v. State of New York, 79

N.Y.2d 39, 580 N.Y.S.2d 153 588 N.E.2d (N.Y. Ct. App. 1992).

Three reported decisions followed Surrogates I. All three were in accord with Surrogates I. See association of Surrogates and Supreme Court Reporters v. State of New York, 78 N.Y.2d 933, 573 N.Y.S.2d 19, 577 N.E.2d 10 (1991), cert. denied, 60 U.S.L.W. 2489 (1992) (Surrogates II); Association of Surrogates and Supreme Court Reporters v. State of New York, 577 N.Y.S.2d 386 (N.Y. App. Div. 1991); and Association of Surrogates and Supreme Court Reporters v. State of New York, 79 N.Y.2d 39, 580 N.Y.S.2d 153, 588 N.E.2d 51 (N.Y. Ct. App. 1992).

Again in 1991, the New York State Assembly enacted another lag-payroll plant to reduce a budget deficit. The Second Circuit responded in a similar

manner as it had in Surrogates I by indicating that "forced loans to the State from its employees" were improper. Condell v. Bress, 983 F.2d 415 (2d Cir. 1992), cert. denied 113 S.Ct. 1849 (1993). In reaching this conclusion, the Condell court asserted that a more serious fiscal crisis would have to develop before the State could justifiably seize public employees' salaries. In Judge Murgnahan's dissent from denial of petition for rehearing en banc he stated, "[t]he two-member panel majority opinion infringes on the holdings in Condell v. Bress ... holding that a...statute deferring state employees salary payments violated the Contracts Clause because it was not reasonable and necessary to further an important public purpose..." App. 41.

In AFSCME/Iowa Council 61 v. State, the court evaluated the effect of the State's impairment of its own contracts:

> It would be no favor to the State to exonerate it from contractual liability. To do so would seriously impair its ability to function. A government must finance its affairs...It would lead to untenable results if a government, after having contracted for needed things, did not have to pay for them.

AFSCME/Iowa Council 61 v. State, 484 N.W.2d 390, 394 (Iowa, 1992). A Washington court indicated a similar sentiment and added that, "[f]inancial necessity, though superficially compelling, has never been sufficient of itself to permit states to abrogate contracts." Carlstrom v. State, 103 Wash.2d 391, 396, 694 P.2d 1, 5 (1985). See also State of Nevada Employees Association v. Keating, 903 F.2d 1223, 1228 (9th Cir. 1990) ("Nevada should not

have interfered with the refund right of public employees when it was looking for ways to fund an increase in post-retirement benefits."); and Opinion of the Justices, 609 A.2d 1204, 1210 (N.H. 1992) ("...the state cannot resort to contract violations to solve its financial problems.").

Finally, the Florida Supreme Court, in Chiles v. United Faculty of Florida, struck down a wage increase given to public employees through collective bargaining. Chiles v. United Faculty of Florida, 615 So.2d 671, 675 (Fla. 1993). In finding this action inconsistent with the strictures of the Contract Clause, the court held that in order for the legislature to be justified in impairing the State's contracts with its public emloyees, it must show that funds are not readily available from any other source.

Id. This reasoning was espoused by Judge Murgnahan in his dissenting opinion from the Fourth Circuit's denial of petition for rehearing en banc. Judge Murgnahan stated, "[t]he City should have considered several items in the budget which could have been cut, without any impairment of contract occuring, thereby insuring that the budget would be balanced. Besides issuance of bonds, reduction of support for cultural institutions comes immediately to mind." App. 38.

Judge Murnaghan proceeded to question the necessity and reasonableness of the furlough program.

> What was done was by no means necessary. Its reasonableness is quite dubious. At most, it minimized somewhat the political dissatisfaction of Baltimore voters which could be expected by City Council members if funding for cultural activities were reduced or taxes raised. The pay reduction,

> though it clearly impaired the obligation of contract, could only benefit the political interest of City Council members who regularly must run for reelection.

App. 39.

C. The Fourth Circuit's Decision Will Likely Have a Broad and Far Reaching Impact.

The issue involved in this case is one of substantial importance because it could affect the rights of countless individuals employed by federal and state governments in an era when governments are seeking to cut costs. By reversing the decision of the United States District Court for the District of Maryland, the court below acted contrary to state employees' rights guaranteed by the contract clause of the United States Constitution.

The setting in which the action that gave rise to this appeal developed is one that is becoming typical--the State was faced with a shortfall in expected revenue and as a result it reduced its appropriation to cities. Baltimore's decision to furlough its public employees is typical also of the many city's responses. The Fourth Circuit's ruling, in effect, gives carte blanche to municipalities to abrogate their contracts with public employees.

The Fourth Circuit's ruling creates an unworkable standard among the circuits. In the words of Judge Murnaghan, "[t]here is...substantial authority, federal and state, appearing to contradict the opinion of the two-judge panel majority. A conflict of circuits emerges on an item of potentially immense importance." (App.

43). It is therefore respectfully requested that this Court grant certiorari in this case.

Respectfully submitted

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## OPINION

LUTTIG, Circuit Judge:

In response to budgetary shortfalls, Baltimore City implemented a plan under which it ultimately reduced the annual salaries of its employees by approximately 1%, through deductions from five of their semi-monthly paychecks. Its teachers and police, through their certified collective bargaining units, brought suit alleging that the salary reductions constituted an impermissible impairment of their contracts with the City. The district court entered judgment in their favor, and we now reverse.

I.

The facts essential to the resolution of this case are simple and not in dispute. Baltimore has what is commonly known as an "executive budget

system," the chief executor of which is the City's Board of Estimates. See generally City of Baltimore v. American Fed'n of State, County & Mun. Employees, 379 A.2d 1031, 1034-36 (Md. 1977). Pursuant to the Municipal Employee Relations Ordinance ("MERO"), the police negotiate memoranda of understanding embodying the terms of their employment with the City, which are approved by the Board of Estimates and collected with other budgetary obligations in an Ordinance of Estimates. The Ordinance of Estimates is then enacted into law by the City Council. The process for the City's teachers, though not pursuant to MERO, is apparently similar. The Board of School Commissioners negotiates the terms of employment, which are then approved by the Board of Estimates, included in the Ordinance of Estimates, and enacted into

law by the City Council. It is undisputed that these procedures were followed for Fiscal Year 1992, the period relevant to this litigation.

As of October 1991, Baltimore had lost a total of approximately $24.2 million in state aid, $4.78 million of which was cut pursuant to special authority granted the Governor by the General Assembly meeting in special session. Baltimore responded to this round of cuts with a variety of measures, such as layoffs, elimination of positions, and early retirements. Having failed to reverse the tide of the State's financial fortunes, the Governor announced in December 1991 a new round of proposed cuts in state aid to Baltimore, equal to approximately $13.3 million, and in response Baltimore implemented its so-called furlough plan. Under the plan,

full-time city employees, except for fire fighters, who enjoy certain privileges, lost the annual equivalent of 2.5 days of pay, or .95% of their gross annual salary, and Baltimore saved approximately $2 million, which it does not intend to refund. These salary reductions were less than those originally contemplated under the plan, because it was discontinued midstream after the General Assembly approved only $4.68 million of the cuts proposed by the Governor for Baltimore City.

Seeking restitution, the teachers and police brought suit, charging that their salary reductions violated the Contract Clause, U.S. Const. art. I, § 10 cl. 1 ("No State Shall...pass any...Law impairing the Obligation of Contracts..."). The district court ruled in their favor, and this appeal followed.

II.

Though the Contract Clause is phrased in absolute terms, the Supreme Court does not interpret the Clause absolutely to prohibit the impairment of either government or private contracts. See United States Trust Co. v. New Jersey, 431 U.S. 1, 21 (1977) ("Although the Contract Clause appears literally to proscribe 'any' impairment, this Court observed in Blaisdell that 'the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula.'" (quoting Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 428 (1934))). Rather, it has formulated essentially a three-part analysis for harmonizing the command of the Clause with the "necessarily reserved" sovereign power of the states

to provide for the welfare of their citizens. Id.

As a threshold matter, it must be determined whether there has been impairment of a contract. See, e.g., id. at 17 ("[A}s a preliminary matter, appellant's claim requires a determination that the [law] has the effect of impairing a contractual obligation.") Second, it must be determined "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." Spannaus, 438 U.S. at 244 (emphasis added); see also Bannum, Inc. v. Town of Ashland, 922 F.2d 197, 202 (4th Cir. 1990) (legislation must constitute "a severe impairment of the [contractual] right"). Finally, assuming there has been a substantial impairment of contract, it must be determined

whether that impairment is nonetheless permissible as a legitimate exercise of the state's sovereign powers, an inquiry that differs subtly depending upon whether the contract impaired is a private or, as here, a public one. Analyzing Baltimore's action within this framework, we agree with the district court that the City substantially impaired an extant contract with its teachers and police. We conclude, however, affording the requisite degree of deference to the City's legislature, that the impairment was in exercise of the City's legitimate powers and thus permissible under the Contract Clause.

A.

I.

We have little trouble concluding, as did the district court, see J.A. at 344-45, that Baltimore intended to and

did enter into contractual relationships with its teachers and police, at least upon enactment into law of the Ordinance of Estimates. Cf. United States Trust, 431 U.S. at 17 n.14 ("In general, a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State."); American Fed'n, 379 A.2d at 1035. Upon enactment of the Ordinance, the City Council formally ratified the essential agreement between the City and its employees embodied in the memoranda of understanding and authorized funding for the City's obligations under those memoranda.

There was, we believe, also an impairment of those contracts. The teachers and police indisputably received

less in salary than they were entitled to receive under the terms of their contracts. Only if the employees' salaries were subject to unilateral adjustment by the City under the terms of the contract could it possibly be concluded otherwise. In this regard, the City argues that any contract that existed was expressly subject to the Baltimore City Charter which, it contends, permitted the reductions. Appellants' Br. at 17. We reject this contention.

Given the value ascribed to contracts in our society, and the Constitution's explicit proscription on the state's impairment of contracts, we would not hold, absent the clearest evidence, that the City intended to confer upon the Board of Estimates even the power unilaterally to modify the

City's contracts. We do not read the City Charter as clearly evidencing such an intent. As the City notes, the memoranda of understanding were made explicitly subject to the provisions of the City Charter, see Baltimore, Md., Code art I, §§ 119, 123, and, in any event, contracts generally are understood to incorporate existing law, such as the charter, see Blaisdell, 290 U.S. at 435-36. But section 2 (g) of the Charter, which the City argues most clearly authorizes the modification of contracts, only authorizes the Board of Estimates to effect "reductions...in appropriations." This power does not necessarily subsume the power to modify contracts, and therefore does not clearly evidence an intention to authorize such modifications.

Whether the impairment of the employees' contracts was substantial is a slightly more difficult question, but one that we believe also must be answered in the affirmative. A respect for the vital role of contract generally informs the "substantiality" inquiry:

> The severity of an impairment of contractual obligations can be measured by the factors that effect the high value the Framers placed on the protection of private contracts. Contracts enable individuals to order their personal and business affairs according to their particular needs and interests. Once arranged, those rights and obligations are binding under the law, and the parties are entitled to rely on them.

Spannaus, 438 U.S. at 245. The Supreme Court, however, has provided little specific guidance as to what constitutes a "substantial" contract impairment. It is clear that not all impairments are substantial for Contract Clause purposes.

"Technical" impairments, for example, do not necessarily rise to the level of constitutional violations. See id. ("Minimal alteration of contractual obligations may end the inquiry at its first state."); see also United States Trust, 431 U.S. at 21 ("A finding that there has been a technical impairment is merely a preliminary step in resolving the more difficult question whether that impairment is permitted under the Constitution.") By the same token, there is plainly no requirement of total repudiation. See Energy Reserves, 459 U.S. at 411 ("Total destruction of contractual expectations is not necessary for a finding of substantial impairment."); United States Trust, 431, U.S. at 26. The ground between these spectral ends, though, has yet to be charted with any precision.

While the Court has not refined the analysis for assessing the substantiality of an impairment, it has appeared to assume that an impairment is substantial at least where the right abridged was one that induced the parties to contract in the first place, see El Paso, 379 U.S. at 514 ("We do not believe that it can seriously be contended that the buyer was substantially induced to enter into these contracts on the basis of a defeasible right to reinstatement..."); Spannaus, 438 U.S. at 243 n.14 (noting that El Paso Court concluded that the "'measure taken...was a mild one indeed'" because it did not affect term that induced contract (quoting 379 U.S. at 616)); see also id. at 245 & n.17 (citing to n.14 discussion of El Paso's inducement inquiry in support of statement that "minimal alteration" of contract

obligations may not violate Clause), or where the impaired right was one on which there had been reasonable and especial reliance, see e.g., Spannaus, 438 U.S. at 246 (noting that state law changed obligations "in an area where the element of reliance was vital"); id. ("[The company] relied heavily, and reasonably, on this legitimate contractual expectation...."); id. ("Thus, a basic term of the pension contract - one on which the company had relied for 10 years - was substantially modified.").

The Court, thus, has refused to invalidate a state's statute of repose, on the ground that the reinstatement right affected by the statute "was not the central undertaking." See El Paso, 379 U.S. at 514. Similarly, because the affected party could not have relied upon receipt of such benefits, the Court has

"regarded the elimination of unforseen windfall benefits as a reasonable basis for sustaining changes in statutory deficiency judgment procedures." United States Trust, 431 U.S. at 31 n.30 (citing cases). It sustained in Richmond Mortgage Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124, 130 (1937), for example, a state law that "recognize[d] the obligations of [the mortgagee's] contract and his right to its full enforcement but limit[ed] that right so as to prevent his obtaining more than his due." And the Court has approved modifications of contractual provisions on which there could have been no reliance, either because the parties explicitly provided or because they should have recognized, that the particular rights were necessarily subject to legislative impairment. See

supra note 6 (citing Energy Reserves and Veix).

Based upon these authorities, we are confident that, at the very least, where the contract right or obligation impaired was one that induced the parties to enter into the contract and upon the continued existence of which they have especially relied, the impairment must be considered "substantial" for purposes of the Contract Clause.

In the employment context, there likely is no right both more central to the contract's inducement and on the existence of which the parties more especially rely, than the right to compensation at the contractually specified level. Accordingly, we believe that the salary reductions at issue constituted a substantial impairment of

the employees' contract with the City of Baltimore.

B.

This does not end the analysis, however. 'The Contract Clause is not an absolute bar to subsequent modification of a State's own financial obligations.' United States Trust, 431 U.S. at 25. We must yet "attempt to reconcile the strictures of the Contract Clause with the 'essential attributes of sovereign power' necessarily reserved by the States to safeguard the welfare of their citizens." Id. at 21 (quoting Blaisdell, 290 U.S. at 435) (citation omitted); see also id. at 23 ("In short, the Contract Clause does not require a State to adhere to a contract that surrenders an essential attribute of its sovereignty.") El Paso, 379 U.S. at 509 ("The reserved power cannot be construed so as to

destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects."); cf. United States Trust, 431 U.S. at 23 n.20 ("[A] state is without power to enter into binding contracts not to exercise its police power in the future.") As where a government modifies a wholly private contract, a government modification of its own financial obligations must be "reasonable and necessary to serve an important public purpose." Id. at 25; see also Energy Reserves, 459 U.S. at 411 ("If the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation...."); Keystone Bituminous Coal Ass'n v. DeVenedictis, 480 U.S. 470, 505 (1987) ("significant and legitimate

public purpose"); see also Energy Reserves, 459 U.S. at 412 ("The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests."). Neither the teachers nor the police disputes that ensuring the financial integrity of the City is a significant public purpose. Both argue, however, that the furlough plan was neither reasonable nor necessary to achieve this purpose.

When a state acts to impair private contracts, "courts properly defer to legislative judgments as to the necessity and reasonableness of a particular measure." United States Trust, 431 U.S. at 23. Public contracts stand on a somewhat different footing. Because "the State's self-interest is at stake," id.

at 26, these contracts occupy what the Court has termed a "special status" for Contract Clause purposes, id, and must be more scrupulously examined, see, e.g., Spannaus, 438 U.S. at 244 & n.15. Unlike with respect to state impairments of private contracts, "complete deference" to legislative assessments of the reasonableness and necessity for modifying public contracts is not appropriate. United States Trust, 431 U.S. at 26 (emphasis added). While complete deference is inappropriate, however, at least some deference to legislative policy decisions to modify these contracts in the public interest must be accorded. See Continental Ill. Nat'l Bank & Trust Co. v. Washington, 696 F.2d 692,701 (9th Cir.) ("Because the State is a contracting party, we give less deference to its claims of

justification for impairment." (emphasis added, citing United States Trust, 431 U.S. at 25-26)), appeal dismissed, 460 U.S. 1077 (1983); Local 589, Amalgamated Transit Union v. Massachusetts, 666 F.2d 618,643 (1st Cir. 1981) (Even in cases involving public contracts, "where economic or social legislation is at issue, some deference to the legislature's judgment is surely called for."), cert. denied, 457 U.S. 1117 (1982). But cf. Nevada Employees Ass'n, Inc. v. Keating, 903 F2d 1223, 1226 (9th Cir.) (Court's decisions "do not indicate that the Court would defer to state legislatures when public as opposed to private contracts are at issue."), cert. denied, 498 U.S. 999 (1990). The district court afforded essentially no deference whatsoever to Baltimore's determinations of the reasonableness and

necessity of the salary reductions, see J.A. at 351 ("Alternatives always exist to imposing the costs of budgetary shortfalls on a class of contracting parties such as city employees."), and it is at least in part because of this failure that it erred.

It is not enough to reason, as did the district court, that "[t]he City could have shifted the burden from another governmental program," or that "it could have raised taxes." Id. (emphasis added). But see Surrogates, 940 F.2d at 773. Were these the proper criteria, no impairment of governmental contract could ever survive constitutional scrutiny, for these courses are always open, no matter how unwise they may be. Our task is rather to ensure through the "necessity and reasonableness" inquiry that states

neither "consider impairing the obligations of [their] own contracts on a par with other policy alternatives" or "impose a drastic impairment when an evident and more moderate course would serve its purposes equally well," United States Trust, 431 U.S. at 30-31, nor act unreasonably "in light of the surrounding circumstances," id. at 31.

We are satisfied that Baltimore City did neither. Required by law to balance its budget, the City took what they believe to be needed and measured steps to absorb extraordinary reductions in revenue. By October 1991, facing a deficit of some $450 million, the State of Maryland had dramatically decreased funding to local governments for Fiscal Year 1992, with the net effect that Baltimore lost approximately $24.2 million in state aid. In response to

these cuts, the City, which was already suffering from the sluggish economy and poor financial management, not only abandoned previously negotiated pay raises but also effected other nonsalary cost savings. Because personnel costs constitute such a large percentage of its expenditures (for example, 91.8% of the Police Department budget and 82.5% of the Public School budget), however, Baltimore was also forced to resort to such measures as layoffs, job abolishment, and early retirements.

In December 1991, nearly midway through the fiscal year, the State proposed an eleventh-hour, second round of cuts in state aid to the City, totaling approximately $13.3 million. Only then, and only in order to maintain its budget in balance and avoid further layoffs, did the City resort to the

furlough plan at issue here. The City's obvious reluctance to resort to the plan and its decision to do so only when it concluded that it had no better alternative belies the "political expediency" suspected in Surrogates, 940 F.2d at 773, and confirms that the City did not consider salary reductions on par with other policy choices, see United States Trust, 431 U.S. at 29-31.

Nor on such facts as these can we conclude that the City chose a drastic impairment over an equally acceptable, more moderate course. First, the amount of reduction was no greater than that necessary to meet the anticipated shortfall. See United States Trust, 431U.S. at 29-30 (criticizing "total repeal" of bond covenant when "a less drastic modification would have permitted the contemplated plan without entirely

removing the covenant's limitations"). Second, the city discontinued the plan immediately upon recognition that the budgetary shortfall would not be so great as anticipated. See Energy Reserves, 459 U.S. at 418 (noting approvingly that "the Act is a temporary measure that expires when federal price regulation of certain categories of gas terminates."). Finally, the plan did not alter pay-dependent benefits, overtime pay, hourly rates of pay, or the orientation of pay scales. See United States Trust, 431 U.S. at 27 ("The extent of impairment is certainly a relevant factor in determining its reasonableness.") Indeed, the plan was less drastic than at least one alternative, additional layoffs, which could have been more detrimental to appellees. See Faitoute Iron & Steel Co. v. City of Asbury Park,

316 U.S. 502, 516 (1942) (upholding law affecting municipal bond terms in part because it benefited the bond holders); see also Reply Br. at 13 ("Appellees advance no basis for disputing the fact that the pay reduction was an alternative, presumably a preferred alternative, to layoffs."). In short, the City clearly sought to tailor the plan as narrowly as possible to meet its unforseen shortfalls.

We also conclude that the salary reductions were reasonable under the circumstances. In addition to its careful tailoring, the furlough plan possessed, not insignificantly, each of the attributes identified in Spannaus as present in various state laws that had impaired private contracts but survived Contract Clause challenge. First, the plan was designed to "deal with a broad,

generalized economic or social problem." 438 U.S. at 250 (citing Blaisdell, 290 U.S. at 445); see also Exxon, 462 U.S. at 191 (noting approvingly that the statute "did not prescribe a rule limited in effect..., but instead imposed a generally applicable rule of conduct designed to advance 'a broad societal interest'" (quoting Spannaus, 438 U.S. at 249)); id. at 192 ("main effect" of Act was "shielding consumers"). Indeed, according to the City, prior to implementation of the furlough plan, "[i]t was approaching the point where it[had] to begin cutting basic services and initiating the breakdown of government." Appellants' Br. at 21.

Similarly, unlike the special interest character of the legislation at issue in Spannaus, Baltimore's plan did not narrowly target specific classes of

employees; it extended to all City employees. See Exxon, 462 U.S. at 176 ("The prohibition applied to all oil and gas producers...."); id. at 192 ("sharply distinguish[ing]" United States Trust and Spannaus because the measures at issue there imposed no "generally applicable rule of conduct"); Energy Reserves, 459 U.S. at 412 n.13 ("The pension statute [in Spannaus] had a very narrow focus: it was aimed at specific employers."); Spannaus, 438 U.S. at 248.

Third, the plan affected reliance interest not wholly unlike those of private entities in regulated industries, which contract subject to future, additional regulation. See, e.g., Energy Reserves, 459 U.S. at 416; Spannaus, 438 U.S. at 250 (law affected "an area already subject to state regulation" (citing Veix, 310 U.S. at 38)); see also

Exxon, 462 U.S. at 194 n.14 ("Our conclusion is buttressed by the fact that appellants operate in industries that have been subject to heavy regulation."). Public employees - federal or state - by definition serve the public and their expectations are necessarily defined, at least in part, by the public interest. It should not be wholly unexpected, therefore, that these public servants might well be called upon to sacrifice first when the public interest demands sacrifice.

Finally, the plan "effect[ed] simply a temporary alteration of the contractual relationships of those within its coverage." Spannaus, 438 U.S. at 250 (citing United States Trust, 431 U.S. at 22); United States Trust, 431 U.S. at 22 n.19 ("limited duration" of impairments is factor in reasonableness

determination). The City, as noted, immediately discontinued the plan at the first opportunity and correctly does not suggest that it would be free to employ salary reductions as a common budgetary tool in the future.

The authority of the states to impair contracts, to be sure, must be constrained in some meaningful way. The Contract Clause, however, does not require the courts - even where public contracts have been impaired -to sit as superlegislatures, determining, for example, whether it would have been more appropriate instead for Baltimore to close its schools for a week, an option actually considered but rejected, or to reduce funding to the arts, as appellees argue should have been done. Not only are we ill-equipped even to consider the evidence that would be relevant to such

conflicting policy alternatives; we have no objective standards against which to assess the merit of the multitude of alternatives. While the Court today presumably would not accept in the public contract context the absoluteness of Justice Frankfurter's response to a similar request in a private contract context that the Court reject a governor's and legislature's determination that the state's public welfare required further suspension of mortgage foreclosures (or at least not the implication of his response), his essential point is relevant in both contexts: "Merely to enumerate the elements that have to be considered [in determining whether the public welfare decision was reasonable] shows that the place for determining their weight and their significance is the legislature not

the judiciary." East New York Sav. Bank v. Hahn, 326 U.S. 230, 234 (1945).

In light of the magnitude and timing of the proposed cuts in state funding that prompted the City's salary reductions, the undisputed legitimacy of the City's need to balance its budget, the City's concerted efforts to exhaust numerous alternative courses of cost reduction before resorting to the challenged reductions, the circumscribed nature of the furlough plan, and the City's immediate abandonment of the reductions at the first opportunity, we believe - according the legislature some deference but without accepting its assertions uncritically- that Baltimore's plan was, as it must be, "upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption." United States Trust, 431 U.S.

at 22. Accordingly, we conclude that the City's modification of its employees' contracts was an impairment permitted by article 1, section 10.

## CONCLUSION

For the reasons set forth above, the judgment of the district court is reversed, and the case is remanded for further proceedings consistent herewith.

REVERSED AND REMANDED

MURNAGHAN, J., dissenting from denial of petition for rehearing en banc:

I have, albeit unsuccessfully, voted for rehearing en banc and dissent from its denial.

The case involves negotiations whereby members of the Baltimore City police department and public school teachers of the same municipality worked out agreements as to wages with City representatives, subject to recommendation by the City's Board of Estimates and adoption by the City Council in the annual budget. Said recommendation by the Board of Estimates and adoption by the City Council occurred.

During the year involved, there was a shortfall in expected revenue. The State of Maryland reduced its appropriation to the City. The City

moved to remain within balanced budget requirements and decided not to honor in all respects the contractual promises made to he police and the teachers. Two of the three members of the panel rendering the decision which I have wished should be reheard en banc constituted the majority and decided that a substantial impairment of contract resulted from the consequent reduction in salary paid from what had been promised.

The constitutional proviso against impairment of contract, U.S. Court. art. I, § 10, cl. 1 ("No State shall...pass any...Law impairing the Obligation of Contracts..."), applies to a corporate municipality such as Baltimore City. See Northern Pac. Ry. Co. v. Minnesota, 208 U.S. 583, 590 (1908) (stating that it is not "open to question" that the Contract Clause applies to municipal legislation).

Substantial contract impairment by a state or municipality is permissible only if 1) reasonable and 2) necessary. See United States Trust Co. v. New Jersey, 431 U.S. 1, 25 (1977) (holding that the Contract Clause prohibits a substantial impairment of a contractual relationship unless the impairment "is reasonable and necessary to serve an important public purpose").

The panel majority determined that deference should be accorded to the Board of Estimates, which ordered the reduction in pay (i.e., breaches of contract), treating such orders as legislative in nature although the City Council did not make or approve them. The fact that the Board of Estimates engages somewhat in what amounts to part of the legislative process, and therefore has freedom from the obligation to testify, see Baker v.

testify, see Baker v. Mayor and City Council of Baltimore, 894 F.2d 679, 682 (4th Cir.), cert. denied, 498 U.S. 815 (1990), does not elevate its steps to the dignity of actual legislation. But whether the breach of contract was legislative or not, it was not proper, in any event, as legislation. The pay reduction impairing contractual undertakings was an improper abdication of the responsibility to see that the federal constitution is complied with. The City should have considered several items in the budget which could have been cut, without any impairment of contract occurring, thereby insuring that the budget would be balanced. Besides issuance of bonds, reduction of support for cultural institutions comes immediately to mind. The City, disliking such cuts, even though they would not

represent breaches of contract, could alternatively impose taxes to meet the reduction in state revenues allocated to the City which would be at a level not equaling the highest level reached by the City in the past.

What was done was by no means necessary. Its reasonableness is quite dubious. At most, it minimized somewhat the political dissatisfaction of Baltimore voters which could be expected by City Council members if funding for cultural activities were reduced or taxes were raised. The pay reduction, though it clearly impaired the obligation of contract, could only benefit the political interest of City Council members who regularly must run for reelection. To avoid what politics would have rendered unpopular, Baltimore City chose to ignore, that is to break,

contracts and thereby to interfere quite unfavorably with the bargained rights, namely the livelihood of important city workers, the police and public school teachers. See Association of Surrogates & Supreme Court Reporters v. New York ("Surrogates I"), 940 F.2d 766, 773 (2d Cir. 1991) ("In fact, the [scheme at issue here] smacks of the political expediency that United States Trust Co. warned of: 'A governmental entity can always find a use for extra money, especially when taxes do not have to be raised.'" (quoting United States Trust Co., 431 U.S. at 26)), cert. denied, 112 S. Ct. 936 (1992); cf. Association of Surrogates & Supreme Court Reporters v. State ("Surrogates II"), 79 N.Y. 2d 39, 47, 588 N.E.2d 51, 54 580N.Y.S.2d 153, 156 (1992) (noting that the deferral of state employees' salaries was "not an

insubstantial impairment to one confronted with monthly debt payments and daily expenses for food and the other necessities of life"). The two-member panel majority opinion infringes on the holdings in Condell v. Bress, 983 F.2d 415, 419-20 (2d Cir.) holding that a December 1990 statute deferring state employees' salary payments violated the Contract Clause because it was not reasonable and necessary to further an important public purpose), cert. denied,113 S.Ct. 1849 (1993); "Surrogates I", 940 F.2d at 773 (holding that a May 1990 statute deferring state employees' salary payments was "in no way 'necessary' to the achievement of the [state legislature's] stated goals"); "Surrogates II" 79 N.Y.2d at 46 (holding unanimously that a 1991 statute deferring state employees' salary payments was not

"reasonable and necessary to accomplish the State's purposes"); and Carlstrom v. State, 103 Wash.2d 391, 396-97, 694 P.2d 1, 506 (1985) (holding unanimously that a state statute canceling teachers' contractual salary increases violated the Contract Clause because it was not reasonable). See also Opinion of the Justices, 135 N.H. 625, 636, 609 A.2d 1204, 1211 (1992) (concluding unanimously that a "furlough" bill requiring certain state employees to take unpaid leave would violate the Contract Clause because it would be "neither reasonable nor necessary to serve an important public purpose"); cf. Sonoma County Org. of Pub. Employees v. County of Sonoma, 23 Cal.3d 296, 313-14, 591 P.2d 1, 10-11, 151 Cal.Rptr. 903, 912-13 (1979) (holding that a state statute capping local governmental employees' contractual cost-

of-living wage increases violated the Contract Clause because the state's supposedly "grave fiscal crisis" did not actually constitute a significant and legitimate public purpose).

There is thus substantial authority, federal and state, appearing to contradict the opinion of the two-judge panel majority. A conflict of circuits emerges on an item of potentially immense importance. Accordingly, I dissent from the denial of en banc rehearing.

/s/ Francis D. Murnaghan, Jr.
Francis D. Murnaghan, Jr.
United States Circuit Judge